

Notice of Proposed Regulatory Action
The State Board of Equalization Proposes to Adopt Amendments to
California Code of Regulations, Title 18,
Section 1705, *Relief From Liability*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1705, *Relief From Liability*, which implements, interprets, and makes specific RTC section 6596's provisions for relief from sales and use tax liabilities due to reasonable reliance on written advice from the Board. The proposed amendments add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The proposed amendments add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The proposed amendments to Regulation 1705, subdivision (a), clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on December 17-19, 2013. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on December 17, 18, or 19, 2013. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1705.

AUTHORITY

RTC section 7051

REFERENCE

RTC section 6596

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current Law

RTC section 6005 currently defines the term “person” for purposes of the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.). It provides that the term includes “any individual, firm, partnership, joint venture, limited liability company, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this state, any county, city and county, municipality, district, or other political subdivision of the state, or any other group or combination acting as a unit.”

Currently, under RTC section 6596, subdivision (a), if the Board finds that a person’s failure to make a timely return or payment is due to the person’s reasonable reliance on written advice from the Board, the person may be relieved of sales and use taxes and any penalties or interest added thereto (hereafter referred to as RTC section 6596 relief).

Currently, under RTC section 6596, subdivision (b), a person’s failure to make a timely return or payment is due to reasonable reliance on written advice from the Board only if the Board finds that:

- The person submitted a written request to the Board for advice about whether a particular activity or transaction is subject to sales and use tax and fully described the specific facts and circumstances of the activity or transaction in the request;
- The Board responded to the written request for advice in writing and stated whether or not the described activity or transaction is subject to tax, or stated the conditions under which the activity or transaction is subject to tax;
- In reasonable reliance on the Board’s written advice, the person did not charge sales tax reimbursement or collect use tax from his or her customers or pay a use tax on the described activity or transaction; and
- The liability for taxes due to the failure to make a timely return or payment applied to a particular activity or transaction which occurred before the Board rescinded or modified the written advice or the Board’s earlier written advice ceased to be valid due to a change in the law.

Also, currently, RTC section 6596, subdivision (d), generally provides that “[o]nly the person making the written request shall be entitled to rely on the [B]oard’s written advice to that person.”

Regulation 1705 implements, interprets, and makes specific the provisions of RTC section 6596. As relevant here:

- Regulation 1705, subdivision (b)(1), currently requires that a representative's written request for advice identify the specific person for whom the advice is requested in order for the identified person to rely on the advice in the Board's written response to the representative for RTC section 6596 relief;
- Regulation 1705, subdivision (c) currently applies to audits, states that the "[p]resentation of [a] person's books and records for examination by an auditor shall be deemed to be a written request for the audit report," and prescribes the circumstances under which an audit report may be relied upon for RTC section 6596 relief; and
- Regulation 1705, subdivision (a), currently provides that "[w]ritten advice from the Board which was received during a prior audit of the person under the conditions set forth in subdivision (c) below, may be relied upon by the person audited or by a legal or statutory successor to that person."

Also, as relevant here, subdivision (e) was added to Regulation 1705 in 1999 to explain the circumstances under which a trade or industry association may request written advice on behalf of its members so that the members can rely on the written advice for RTC section 6596 relief. And, subdivision (e) of Regulation 1705 was amended in 2009 to explain the circumstances under which a franchisor may request written advice on behalf of its franchisees so that the franchisees can rely on the written advice for RTC section 6596 relief. Subdivision (e) currently provides that:

A trade or industry association requesting advice on behalf of its member(s) must identify and include the specific member name(s) for whom the advice is requested for relief from liability under this regulation. A franchisor requesting advice on behalf of its franchisee(s) must identify and include the specific franchisee name(s) for whom the advice is requested for relief from liability under this regulation.

For an identified trade or industry member or franchisee to receive relief based on advice provided in the written communication to the trade or industry association or franchisor, the activity or transactions in question must involve the same facts and circumstances as those presented in the written inquiry by the association or franchisor.

As a result, a person cannot generally obtain RTC section 6596 relief by relying on written advice the Board gave to another person, even if their activities or transactions are similar. However, Regulation 1705 does currently allow a person to obtain RTC section 6596 relief by relying on written advice the Board gave to the person's representative, trade or industry association, or franchisor under specified circumstances.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1705

Need for Clarification

The Board conducted a hearing regarding a sales and use tax appeal filed by a business entity (hereafter referred to as ABC). During the hearing, ABC indicated that it followed written advice provided during the Board's prior audit of another business entity (hereafter referred to as XYZ). ABC stated that ownership of XYZ was similar to ABC, and that the two companies engaged in the same type of business in the same industry and shared a common accounting department. Also, records indicated that XYZ and ABC were related entities because XYZ owned more than 50 percent of ABC. Therefore, during the hearing, ABC argued that written advice provided to XYZ during its prior audit was indirectly provided to ABC as well, and that ABC should be permitted to rely on the written advice for RTC section 6596 relief. In response to ABC's arguments, the Board referred an issue to the Board's Business Tax Committee for further development. The issue was whether RTC section 6596 relief should only be available to the person who actually received the written advice from the Board or that person's legal or statutory successor under certain circumstances, such as those presented in ABC's appeal.

Business Taxes Committee staff subsequently reviewed the facts of ABC's appeal discussed above. First, staff found that when two persons in the same industry are under common ownership and share accounting functions and accounting staff, and the accounting staff presents one of the person's books and records to Board staff during an audit, then it would be reasonable for the accounting staff, under the direction of a common controlling ownership, to rely on the Board's written advice regarding the application of tax to the activities or transactions at issue in the audit report when conducted by the audited person and the related person. Second, staff found that, in this specific factual situation, the presentation of the audited person's books and records should be deemed to be a written request for the audit report by both the audited person and the related person so that RTC section 6596 relief will apply to a liability the audited person or the related person (having the above characteristics) incurs due to either of their reasonable reliance on the written advice Board staff provided in the audit report. Therefore, staff determined that it was necessary to clarify Regulation 1705 accordingly.

However, the facts of ABC's appeal did not concern ABC's reliance on written advice requested under the circumstances described in Regulation 1705, subdivision (b). Also, Business Taxes Committee staff found that Regulation 1705, subdivision (b) already provides a procedure to request written advice from the Board that identifies two related persons, such as ABC and XYZ, by name, so that both persons can subsequently rely upon the written advice for RTC section 6596 relief. And, staff found that continuing to require a request for written advice submitted on behalf of two related persons to comply with the procedures in Regulation 1705, subdivision (b), is consistent with the procedures in Regulation 1705, subdivision (e) (quoted above) regarding a trade or industry association's or franchisor's request for written advice on behalf of its member(s) or franchisee(s). Therefore, staff did not determine that there was a need to further clarify when related persons may rely on written advice requested from the Board outside of the audit context.

Interested Parties Process

As a result, Business Taxes Committee staff drafted amendments to Regulation 1705, subdivisions (a) and (c). The draft amendments suggested adding language to the end of the first sentence in subdivision (c) to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The draft amendments suggested adding language to the end of subdivision (c) to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person, and require that all of the circumstances exist at the time that an audit report is provided to the audited person in order for the person with shared accounting and common ownership to rely on the audit report for RTC section 6596 relief. The draft amendments also suggested amending subdivision (a) to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

Business Taxes Committee staff subsequently provided its draft amendments to Regulation 1705 to the interested parties and conducted interest parties meetings in April and May 2013 to discuss the draft amendments. During the April meeting, a participant questioned the requirement, discussed above, that a person have shared accounting and common ownership with an audited person at the time that an audit report is issued, in order for the person with shared accounting and common ownership to rely on the audited person's audit report for RTC section 6596 relief. The participant expressed concern that the requirement was too narrow and might prevent a person that was not in business when an audit report was issued, but otherwise has shared accounting and common ownership with the audited person, from relying on the audit report for RTC section 6596 relief when it would seem reasonable to rely on the audit report under the circumstances. As a result, staff addressed the concern by revising its draft amendments to Regulation 1705, subdivision (c) so that a person only has to have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. Staff also revised its draft amendments to add clarifying language and making minor grammatical edits recommended by the interested parties during the May meeting.

August 13, 2013 Business Taxes Committee Meeting

Subsequently, staff prepared Formal Issue Paper 13-006 and distributed it to the Board Members for consideration at the Board's August 13, 2013, Business Taxes Committee meeting. Formal Issue Paper 13-006 recommended that the Board propose to add language to the end of the first sentence in Regulation 1705, subdivision (c), to clarify that the presentation of a person's books and records for examination by an auditor shall be deemed to be a written request for the audit report "by the audited person and any person with shared accounting and common ownership with the audited person." The formal issue paper recommended that the Board propose to add language to the end of Regulation 1705, subdivision (c), to clearly prescribe the circumstances under which a person has shared accounting and common ownership with an audited person and require

that a person have shared accounting and common ownership with an audited person during the periods that the person is entitled to rely on the audited person's audit report for RTC section 6596 relief. The formal issue paper also recommended that the Board amend Regulation 1705, subdivision (a), to clarify that written advice provided under the circumstances described in subdivision (c) may be relied upon by the person audited "or a person with shared accounting and common ownership with the audited person."

At the conclusion of the Board's discussion of Formal Issue Paper 13-006 during the August 13, 2013, Business Taxes Committee meeting, the Board Members unanimously voted to propose the amendments to Regulation 1705 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1705 are reasonably necessary to have the effect and accomplish the objective of addressing the issue presented by the facts of ABC's appeal (discussed above) by clarifying that a person can rely on an audit report issued to another person for RTC section 6596 relief under limited circumstances that are similar to the circumstances in ABC's appeal.

The Board anticipates that the proposed amendments to Regulation 1705 will promote fairness and benefit taxpayers, Board staff, and the Board by clarifying that RTC section 6596 relief can apply to a person who the Board would reasonably expect to rely on written advice provided by Board staff in a prior audit of another related person because the two persons are:

- In the same industry;
- Under common ownership; and
- Share accounting functions and accounting staff.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1705 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1705 or the proposed amendments to Regulation 1705.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1705 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1705 will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7

(commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1705 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1705 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1705 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1705 will not affect the benefits of Regulation 1705 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of the proposed amendments to Regulation 1705 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, by e-mail at Bradley.Heller@boe.ca.gov, or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on December 17, 2013, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1705 during the December 17-19, 2013, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1705. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1705 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1705, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at www.boe.ca.gov.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt the proposed amendments to Regulation 1705 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change

clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Regulation 1705, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at www.boe.ca.gov.